

Pension Funding

The Problem

The Legislature skipped \$325 million general fund state (\$893 million total funds) in actuarially recommended pension payments last session, via ESHB 1044.

The two primary “savings” employed were:

Skipping unfunded liability payments to the teachers’ (TRS) and state & local employees’ (PERS) plan 1 retirement systems. *\$173 M general fund “savings”*

Delaying recognition of the costs of future gain-sharing benefits. *\$147 M general fund “savings”*

These policies result in higher costs to taxpayers and expose the Legislature to suit for failing to fund employees’ pensions in a “sound and systematic” fashion.

The Solution

Senate Republicans continue to support the floor amendment they offered to ESHB 1044 which would have ensured sound & stable funding of the state’s pension systems. The proposal would have:

- Made the required 2005-07 payment and prohibited skipping future contribution payments to the TRS and PERS plan 1 unfunded liabilities;
- Eliminated gain-sharing, and dedicated any “extraordinary gains” to paying off plan 1 unfunded liabilities more quickly; and
- Beginning in 2009, created a minimum employer contribution rate “floor” for the sole purpose of paying off plan 1 unfunded liabilities.

Background

1. Plan 1 Unfunded Liability – What, How Much & Why

What is an unfunded actuarial accrued liability?

An unfunded actuarial accrued liability (UAAL) is the present value of benefits earned to date that are NOT covered by plan assets. In other words, if employees cashed their checks for retirement benefits owed to them, the UAAL represents the amount state and local government employers would be short.

The liability is exclusively the responsibility of employers, not employees.

How did we end up with \$4 billion in unfunded plan liabilities?

Several reasons, including:

- *Original underfunding of plans* – From 1973 through 1991, the Legislature satisfied the full funding requirements of the plans only once. This left the plans substantially underfunded; leading to the current situation of making payments to the plans long after the last employee has retired.
- *Recent skipping of unfunded liability payments* – From 1991 through 2003, the Legislature made every scheduled plan 1 unfunded liability contribution. The Legislature skipped the payments in 03-05 and 05-07. The original 2003-05 SRC/Rossi budget made the payment, but the House D budget skipped the payment. In negotiations, the House Ds won.
- *Poor market returns* – The long-term annual investment return assumption is 8 percent. When returns fall below this amount, unfunded liabilities increase and vice versa. Investment losses in 2001 and 2002 resulted in a significant increase in the amount of unfunded liabilities, although the liability is expected to fluctuate back down due to recent returns.
- *Benefit expansions* – When benefits expand, employers experience more costs. One of the most significant recent benefit expansions was gain-sharing, passed in 1998.
- *Changes in funding policy* – Various changes made over the last decade - all of which resulted in immediate contribution rate reductions - had the effect of increasing the amount needed to pay-off the UAAL.

How much are the TRS and PERS plan 1 unfunded liabilities?

\$4 Billion: PERS 1 = \$2.6 billion and TRS 1 = \$1.4 billion.

It is important to note these figures can ebb and flow over time, as benefit expansions, changes in funding policy, and market returns can all alter the plan 1 unfunded liabilities. The \$4 billion liability, however, is the highest in nearly a decade.

The liability is statutorily scheduled to be paid off by 2024. It would be hard to defend pushing back the pay-off date, considering the last PERS and TRS plan 1 employee began employment back in 1977.

2. Gain-Sharing

What is Gain-Sharing?

Gain-sharing, passed in 1998, is the sharing of the state's "extraordinary investment gains" with employees in the form of enhanced benefits. "Extraordinary investment gains" are defined as four consecutive years in which the compounded average return exceeds 10 percent. Employees in PERS 1 and 3, TRS 1 and 3, and SERS 3 are eligible for this benefit.

Why is gain-sharing an issue?

Portrayed in 1998 as having no fiscal cost to the state, the current state actuary concluded gain-sharing was a material liability not currently being funded. The cost of funding this liability was projected at \$147 million in 05-07 and similar amounts in future biennia.

The 2005-07 budget chose to “delay” recognition of these material costs, and directed the Select Committee on Pension Policy to “study the options available for addressing the liability associated with future gain-sharing benefits.”

The options, in essence, boil down to repealing the benefit (on the premise that it was sold as a “cost-free” option, which was false), funding the benefit, or replacing the benefit with a comparable but different benefit.

Is it possible to repeal gain-sharing?

Generally, once pension benefits are granted there is a vested contractual right to continuing and funding those benefits. However, the Legislature specifically disavowed any contractual rights when it established gain-sharing, stating:

“The Legislature reserves the right to amend or repeal this section in the future and no member or beneficiary has a contractual right to receive this distribution not granted prior to that time.” RCW 41.31A.030. See also RCW 41.31A.020 (4), .030(5), and .040(5).

The legality of a “non-contractual rights clause” has never been tested in court. However, on Nov. 2, 2005, the Attorney General’s office issued AGO 2005 #16 which concluded employees had no contractual right to future gain-sharing distributions and that the Legislature could legally repeal the benefit.